Petition

81-1467

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No. .....

IN THE

Supreme Court of the United States

OCTOBER TERM, 1981

ALLEN D. UNVERT and CATHERINE R. UNVERT

Petitioners,

VS.

COMMISSIONER OF INTERNAL REVENUE

Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

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QUESTION PRESENTED

Whether the scope of the tax benefit rule may be judicially expanded, beyond boundaries established by this Court and the Tax Court of the United States, to permit later recoupment of earlier taxpayer error, correction of which in the year made is barred by the statute of limitations.

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Petitioners,

vs.

COMMISSIONER OF INTERNAL REVENUE

Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

ALLEN D. UNVERT and CATHERINE R. UNVERT petition for a writ of certiorari to review the judgment of the United States Court of Appeals for the Ninth circuit in this case.

OPINIONS BELOW

The findings of fact and opinion of the Tax Court (Appendix A, *infra*, pp. A-A15) are reported at 72 TC 807. The opinion of the court of appeals (Appendix B, *infra*, pp. B-B7) is reported at 656 F.2d 483.

JURISDICTION

The judgment of the court of appeals was entered on September 14, 1981 (Appendix C, *infra*, p.). The Petitioner's timely filed petition for rehearing *en banc* was denied on November 6, 1981 (Appendix D, *infra*, p.). The jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1).

QUESTION PRESENTED

Whether the scope of the tax benefit rule may be judicially expanded, beyond boundaries established by this Court and the Tax Court of the United States, to permit later recoupment of earlier taxpayer error, correction of which in the year made is barred by the statute of limitations.

STATUTES INVOLVED

The pertinent provisions of the Internal Revenue Code of 1954 ("Code") are set forth in Appendix E, *infra*, pp.

STATEMENT

Like *Hillsboro National Bank v. Commissioner*, 641 F.2d 529 (1981), *certiorari* granted, Docket No. 81-485, (Jan. 18, 1982), this case is also at the outer limits of the tax benefit rule. Common to both cases is the question of whether recovery of an item deducted in a prior year should be treated transactionally in the year of recovery to produce a unitary result. What distinguishes the cases is the deduction, initially proper in *Hillsboro* and improper in this case. As this case involves later correction of earlier taxpayer error, its implications go beyond the tax benefit rule.

The tax benefit rule operates to include in current income a recovery of an item that was deducted in a prior year, but exclude recovery amounts from current income if the prior deduction did not produce a tax benefit. *Nash v. United States*, 398 U.S. 1 (1970); *Dobson v. Commissioner*, 321 U.S. 231 (1944); Section 111 of the Code. The Tax Court has long held

that the tax benefit rule also operates to exclude recovery amounts from current income if the prior deduction was not proper. *Canelo v. Commissioner,* 53 TC 217 (1969), *aff'd* on another issue, 447 F.2d 484 (9th Cir. 1971); *Streckfus Steamers, Inc. v. Commissioner,* 19 T.C. 1 (1952).[1] This latter exclusionary rule is known as the "erroneous deduction exception" (the "exception") to the tax benefit rule.[2]

The exception is not an invitation to tax abuse. In *Mayfair Minerals, Inc. v. Commissioner,* 56 T.C. 82 (1971), *aff'd per curiam,* 456 F.2d 622 (5th Cir. 1972), where the taxpayer's disclosure of improper deductions and their recovery on its returns was misleading, and the taxpayer failed to correct the erroneous deductions through timely amended returns when it could have done so, the court found the taxpayer estopped by its conduct from claiming the benefit of the exception.[3]

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[1] See also *Southern Pacific Transportation Co. v. Commissioner,* 75 T.C. 497 (1980), decided while this case was pending on appeal; *Kingsbury v. Commissioner,* 75 T.C. 1068, 1087-1088 (1976); *Kenneth V. LaCroix v. Commissioner,* 61 TC 471 (1974); Twitchco, Inc. v. United States, 348 F.Supp. 330, 335 (DC Ala. 1972); *B. C. Cooke & Sons, Inc.* 59 T.C. 516 (1971); *Studebaker-Packard v. U.S.,* 61-2 USTC para. 9551, 8 AFTR 2d 5058 (DCND Ind. 1961); *Pancoast Hotel Co. v. Commissioner,* 2 T.C. 382 (1932).

[2] Labeling the exclusion an exception to the tax benefit rule seems a strange choice of words. As the tax benefit rule itself represents an exception to the annual accounting concept laid down by this Court in *Burnett v. Sanford & Brooks Co.,* 282 U.S. 359 (1931), any exception to the tax benefit rule is an exception to an exception, and thus but a restatement of the rule itself. "For items improperly deducted, the correction should be made by elimination of the items from the year in which taken through the use of an amended return or a timely deficiency notice." *Kenneth V. LaCroix, supra,* Fn 1, at p.481.

[3] The taxpayer accrued and deducted potential refunds to its customers in the years 1975-1960, notwithstanding it was concurrently appealing its obligation to do so. Moreover, information relating to the deductions was not fully and adequately disclosed on its tax returns. In 1969, when the taxpayer prevailed in its appeal, and the order to make such refunds was rescinded, the taxpayer did not file amended returns as required by Treas. Reg. § 1.461-1(a)(3)(i). Instead, the taxpayer sat back and knowingly let the statute run on the years in which the erroneous deductions were taken.

In this case Petitioner[4] recovered in 1972 a payment he made and erroneously deducted in 1969. Relying upon the exception, the Petitioner did not include the recovery in his 1972 income. At trial, the Commissioner argued alternatively that: (1) the deduction was proper in 1969; and, (2) if not proper, the Petitioner was under a duty to consistently report the recovery in 1972; and, (3) if not under a duty of consistency, the Petitioner was estopped to assert the exception.

The Tax Court held for the Commissioner. It distinguished this case from *Canelo;* and held that Petitioner was under a duty to treat his recovery in 1972 consistently with the deduction of his payment in 1969, and further that Petitioner was estopped to assert the bar of the statute of limitations because of his conduct after the Commissioner commenced his audit of Petitioner's 1970 and 1971 returns in the fall of 1972.

On brief to the court of appeals the Commissioner argued for the first time that the exception has no validity, and that he was proceeding to revoke his long-standing acquiescences in *Canelo* and *Streckfus Steamers.*[5] Believing that the Tax Court's way was "inferior" to rejection of the exception outright, the court of appeals rejected the exception and affirmed the decision of the Tax Court.

The additional facts involved are not complex and may be briefly stated. Petitioner, believing that he had acquired condominiums from U.S. Financial Corp. ("USF") and was obligated for their purchase price, prepaid and deducted one year's interest in 1969.[6] Petitioner did not learn that the deduction was erroneous until August 1973, when the Commissioner completed his examination of Petitioner's 1970 and 1971

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[4] References to "Petitioner" are to Allen D. Unvert herein. His wife, Catherine R. Unvert, is a party solely because she and Petitioner filed a joint return in 1972.

[5] 1971-1 C.B. 2; 1953-1 C.B. 6.

[6] Section 461(g), added to the Code by Section 208(a) of Public Law 94-455, October 4, 1976, now denies this deduction; as prepaid interest, unless paid in the form of certain charges or points for the purchase of a principal residence, must be deducted daily on a pro-rata basis.

returns and informed Petitioner that his acquisition of the condominiums from USF had never been consummated. The Commissioner assessed deficiencies for the years 1970 and 1971. Correction of Petitioner's 1969 return was barred by the statute of limitations.[7]

In May, 1972, USF gave back petitioner's 1969 payment. Petitioner testified at the trial that he thought this recovery was something to be taken into account in his 1972 return; and that he gave no thought to amending his 1969, 1970 and 1971 returns. He further testified that it was not until the preparation of his 1972 return, in late September, early October, 1973,[8] after the Commissioner's determination for the years 1970 and 1971 had been made known, that he learned of possible errors in his condominium-related deductions in his earlier returns.[9]

REASONS FOR GRANTING THE WRIT

1. Rejection of the Exception Substantially Undermines the Statute of Limitations in Tax Matters.

This case may seem at first blush too inconsequential and too correct to grant *certiorari,* but the issue it presents is of no small significance to the statute of limitations in tax matters. To sweep away years of precedent and undermine the statute, because the court of appeals feels the exception is not good public policy and constitutes an unwarranted leak in the revenues, is a serious mistake.

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[7] Section 6501 of the Code. Generally, the Service has three years from the date "the return is filed" to assess a deficiency in tax for such year; which in this case was April 15, 1973.

[8] The filing date of Petitioner's 1972 returns had been duly extended to October 15, 1973, because of Petitioner's earlier heart attack, resulting disability and open heart surgery in the spring of 1973.

[9] The Tax Court made no finding as to Petitioner's lack of credibility, and even if it did, mere disbelief in Petitioner's testimony cannot support on its own an affirmative finding that Petitioner knew of the errors in his 1969, 1970 and 1971 returns before August, 1973. *Collman v. Commissioner,* 511 F.2d 1263 (9th Cir. 1975).

The extent to which the statute stands weakened by the Ninth Circuit is best illustrated by analyzing the effect of the rejection of the exception on the accrual basis taxpayer. In *Streckfus Steamers, supra,* the taxpayer innocently, erroneously accrued and deducted a local tax, only to learn later that it did not owe the tax. The Commissioner sought unsuccessfully to include in the taxpayer's income of the year of discovery of the erroneous accrual a sum equal to the earlier erroneous deduction.

Rejection of the exception means that the statute will not bar later correction of an earlier erroneously *accrued* deduction, no matter how innocently made or when discovered. For the accrual basis taxpayer the discovery of an earlier erroneous accrual is its own "recovery,"[10] the accounting entry that eliminates the liability and restores the item to surplus. Only the cash basis taxpayer, and the accrual basis taxpayer who actually makes payment (rather than a simple book accrual), and does not later recover the payment, will avoid later correction of an erroneous deduction after the bar of the statute.

Rejection of the exception also means that while the statute will never bar correction by the Commissioner of an earlier erroneously accrued deduction, correction of an earlier erroneously *omitted* accruable deduction by the taxpayer will continue to be barred by the statute. The properly accruable item erroneously omitted is the tax equivalent of the improperly accrued item erroneously deducted. Rejection of the exception thus means that while discovery of error is its recovery at the Commissioner's level, not so at the taxpayer's level.

Judicially turning a statute of limitations on the fact of economic loss, the unrecovered erroneous deduction, as opposed to the loss to the revenues that is the result of all uncorrected erroneous deductions, regardless of whether "paid

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[10] *Cf. Hillsboro National Bank v. Commissioner, supra,* where the taxpayer paid the local tax in controversy, instead of only accruing it, and the question is whether the taxpayer later "recovered" the tax when it was refunded not to the taxpayer but to the shareholders of the taxpayer.

for" or not, is without precedent. Turning a statute of limitations on loss to the revenues, as opposed to the loss to the taxpayer, giving recoupment to one and not to the other, violates the "indispensible element of fairness" that underlies all statutes of limitations. *Rothensies v. Electric Storage Battery Co.*, 329 U.S. 296, 301(1946).

2. Rejection of The Exception is Contrary to the Judicial Precedent Upon Which The Exception is Based.

Inasmuch as the Commissioner has heretofore acquiesced in the exception, it follows that this is a case of first appellate impression. What the Ninth Circuit seeks by way of support for its opinion, in the decisions and opinions of other courts of appeals, does not exist. Judicial precedent supports the exception, not its rejection.

The cases relied upon by the court of appeals either do not involve an erroneous deduction, or, if they do, they turn on estoppel. By turning the erroneous deduction cases on estoppel, the appellate decisions follow the way of the Tax Court, with the result that rejection of the way of the Tax Court is a rejection of the very judicial precedent that the Ninth Circuit relies upon. It is a curious opinion that finds support in the very precedent it rejects.

As for the merits of the exception, little can be added in support of Petitioner's position to what Judge Dawson said in *Canelo*. Rejection of the exception extends the tax benefit rule beyond boundaries established by this Court in *Nash v. United States, supra,* and *Dobson v. Commissioner, supra.* And as Judge Dawson observed, there is nothing in this Court's decision in *Dobson* that requires a different result than that reached in *Canelo*. 53 T.C. at 226-227.

Rejection of the exception also puts the Ninth Circuit in conflict with those decisions of other courts of appeals that are the foundation of the exception. In *Ross v. Commissioner*, 169 F.2d 483 (1st Cir. 1948), the taxpayer erroneously failed to

include income constructively received. After the statute of limitations had run on the year in which the error was made, the Commissioner sought to include the item in the later year of its actual receipt. The First Circuit held for the taxpayer.[11]

The taxpayers in *Canelo* and *Ross* were both cash basis taxpayers, both made errors in a year barred by the statute of limitations, and both received cash payments in a later year. The only difference in the cases is erroneously omitted income as opposed to an erroneous deduction. It is a difference without a distinction. Whether the error is omission of income or improper deduction, the tax result is the same; if not timely corrected, the revenues stand reduced by reason of operation of the statute.

In *Commissioner v. Schuyler,* 196 F.2d 85 (2nd Cir. 1952), the Second Circuit held that when the Commissioner required the taxpayer to change from the cash basis of reporting income to the accrual basis, and included in gross income closing inventory of the year of change, the taxpayers were properly permitted to deduct opening inventory, notwithstanding it had also been deducted in earlier years.[12]

There is no difference in the result reached in *Streckfus* and *Schuyler,* both accrual basis taxpayers. The double deduction of a deductible item is the equivalent of the single deduction of a non-deductible item. Precedent dictates that "(a) deduction erroneously taken in a prior year cannot be treated as income of a later year on the theory that it will otherwise escape taxation." *Id.* 87. The policy the Ninth Circuit sees in its decision, which would reverse *Ross* and *Schuyler,* is without judicial foundation.

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[11] See also *Hurtz v. U.S.,* 162 Ct. Cl. 855 (1963).

[12] See also *Los Cruces Oil Company, Inc. v. Commissioner,* 62 TC 764 (1974); *B.C. Cooke & Sons, Inc., supra,* Fn 1.

3. "If There are to Be Exceptions to The Statute Of Limitations, It is for Congress Rather Than for The Court to Create and Limit Them."[13]

Congress, in enacting the mitigation provisions of § 1311-1314 of the Code, was well aware of a taxpayer's successful use of an inconsistent position with respect to the same or a related transaction after the statute of limitations had run. The House Report reveals that Congress did not intend to overrule all prior judicial authority permitting taxpayer inconsistency. The legislative prescription is not that the inconsistent position automatically triggers the adjustment of §§1314, but that such position must be adopted in a "determination" as defined in § 1313(a).[14] Such is not this case. *Canelo, supra,* at 226-227.

If, as the court of appeals perceives, the exception constitutes a leak in the revenues not supported by public policy, the error is a product of the legislature's failure to extend the tax benefit rule to include recovery of all earlier deductions, whether erroneously taken or not. This is an error which the legislature should be called upon to reconsider. Rejection of the exception constitutes but a second error to offset what the court of appeals perceives to be a first error. *Nash v. United States, supra; Rothensies v. Electric Storage Battery Co., supra.*

4. Turning Application of The Tax Benefit Rule On Notions of Estoppel, in Order to Leave the Exception Intact, Is Less Drastic in its Consequences and a More Acceptable Judicial Alternative Than Rejection Of the Exception Outright.

As observed by Mr. Justice Jackson: "Both hardships to the taxpayers and losses to the revenues . . . tempt the equity minded judge to seek for ways of relief in individual cases"

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[13] *Rothensies v. Electric Storage Battery Co.*, 392 U.S. 296, 303.

[14] House Report No. 2330, 75th Cong., 3rd Sess. (1938); 1939-1, Part 2, CB 817, 835. Many of the pre-1954 duty of consistency cases, decisions which both applied and rejected the doctrine, involved fact patterns now described in § 1312; e.g., § 1312(7) "Basis of Property After Erroneous Treatment of a Prior Transaction." *Cf. B.C. Cooke & Sons, Inc. v. Commissioner,* 65 TC 422, 428 (1975) *aff'd per curiam,* 584 F.2d 53 (5th Cir. 1978), which held that errors in computing gross income are not items described in § 1312(2).

from the bar of the statute of limitations. *Rothensies v. Electric Storage Battery Co., supra.* p. 302. Such are the ways of the Tax Court and the Ninth Circuit in this case. Some will see in their ways mutual exclusitivity, each court rejecting the way of the other, with the result that both stand rejected; others will not.

The Ninth Circuit's disinclination to follow the way of the Tax Court is understandable. The Tax Court's attempt to distinguish this case from *Canelo* and its finding of wrongful conduct is reminiscent of the way followed by Cinderella's stepmother. The Tax Court took the same shoe horn to the facts and law to fit Petitioner's feet into *Mayfair Minerals'* shoes as Cinderella's stepmother took to fit her daughters' feet into Cinderella's slipper; with the same result. The cases are not distinguishable, *Mayfair Minerals* does not establish a duty of consistency independent of taxpayer conduct, and Petitioner's conduct was not such so as to trigger an estoppel.[15]

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[15] The factual and legal determinations made by the Tax Court, and the implications of its decision, are analyzed in *Bishop, The Tax Benefit Rule After Unvert: Does It Compromise The Statute of Limitations?* 51 J.Tax 272 (1979). The Tax Court's finding of "willful misleading conduct" rests upon an inference drawn from the failure of petitioner's accountant to supply the Commissioner with requested information in the winter of 1972, spring of 1973. The record is replete with Petitioner's repeated requests to USF for this same information before May 1972. Petitioner's accountant did not testify at trial. The Commissioner's agent who audited the Petitioner's 1970 and 1971 returns testified that after his initial contact with Petitioner, and being referred by Petitioner to his accountant, he never again talked to Petitioner until August, 1973. The Tax Court refused to take judicial notice that in these same years USF was "manufacturing" sales to inflate its profits, and engaging in other unlawful acts, which ultimately resulted in the financial failure of USF and prison terms for the officers with whom Petitioner had dealt. See *In Re U.S. Financial Securities Litigation*, 609 F.2d 411 (9th Cir. 1979). The permissible inference is that Petitioner's accountant met with no more success in obtaining information from USF after the audit of Petitioner's 1970 and 1971 returns began than he did before. The "clearly erroneous" rule, *Fed. R. Civ. P.* 52(a), applies to factual inferences drawn from undisputed basic facts. *United States v. United States Gypsum Co.*, 333 U.S. 364, 394. Moreover, estoppel must be affirmatively pleaded and the burden of proof is on the person asserting it. *Fed. R. Civ. P.* 8; *Streckfus Steamers, Inc. v. Commissioner*, 19 T.C. 1 (1951).

As long as the courts and the Commissioner persist in using the terms "estoppel" and "duty of consistency" as legal jacks-of-all trades, judges are forced, willy-nilly, to reject precedent of law and to follow instead the precedent of Humpty Dumpty (from *The Looking Glass*): "When I use a word it means what I choose it to mean—neither more nor less." Consequently, "(t)he field is a very confused one and abounds with conflicting decisions and questionable distinctions."[16] Little wonder the court of appeals sought to avoid this area of tax law.[17]

The Tax Court's decision not to go the way of the court of appeals is the more acceptable judicial alternative, however. The only support for the Ninth Circuit's rejection of the exception is the argument that "while rejection sanctions an indirect recoupment by the Service of its loss after the statute

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[16] *1 Surrey, Warren, McDaniel and Ault, Federal Income Taxation, Cases and Materials* (The Foundation Press, 1973), p. 752. See also 10 *Mertens, Law of Federal Income Taxation*, Chpt. 60, and 4 *Bittker, Federal Taxation of Income, Estates and Gifts* (The Foundation Press, 1981), para. 113.10. "Mistakes committed in closed years are occasionally redressed, in whole or in part, by uncertain and confusing judge-made doctrines of equitable estoppel and recoupment" *Id*, 113-28. The confusion is more apparent than real. Sometimes the result turns on whether the Commissioner pursued a deficiency, or the taxpayer a refund. *Cf. Hurtz v. U.S., supra*, Fn 11; *B.C. Cooke & Sons, Inc. v. Commissioner, supra*, Fn. 14. Many times the "basis cases" sound more in taxpayer election than in taxpayer error.

[17] It is argued that "the fact fixed for one year ought to remain fixed in all its consequences." *Alamo Nat. Bank of San Antonio v. Commissioner*, 95 F.2d 622, 623 (5th Cir. 1928). Whether viewed as "estoppel, or a duty of consistency, or the fixing of fact by agreement," as stated by the Fifth Circuit, in *Alamo Nat. Bank*, at p. 623, or whether viewed as the "transsubstantiation of capital into income," as discussed in 1 *Bittker, supra*, Fn.16, para. 5.7.1, p. 5-45, and argued by the Ninth Circuit in this case, the argument sounds in the notion that two wrongs make a right. The courts simply commit a second error to offset what they perceive to be a first error. Transsubstantiation of estoppel into a simple duty of consistency was summarily dismissed by Judge Learned Hand in *Bennett v. Helvering:* "We see no reason why an innocent mistake should deprive the taxpayer of protection; statutes of limitations . . . presuppose that the original decision may have been erroneous." 137 F.2d 537, 538 (2nd Cir. 1943). Transubstantiation of capital into income was summarily dismissed by Judge Dawson in *Canelo* when he held that since the payments were loans, the repayments were loans and not taxable income. 53 TC 217, 226.

has run on the earlier year, this hardly seems more objectionable than to allow the error to stand and also to exclude the recovery from income when received."[18]

But this argument describes only a result. It is not a matter of whether one result is more or less objectionable than any other, or whether courts are or are not involved in "complex case-by-case adjudication." What matters is that the statute is not judicially or administratively undermined. Accountability for the result the statute produces lies with the legislature that made it, not the courts. The Tax Court's way does not weaken the statute, yet it denies its protection to those who would machinate their tax affairs for the sole purpose of using the statute to defeat the revenues.[19]

The error the Tax Court made in this case is that it left its way clouded and uncertain, with the result that some see in its opinion its rejection of the exception, in fact if not in words.[20] The error of the court of appeals is that it acted too quickly and impulsively when it took what it saw as the next and easier step, rejection of the exception in words as well as in fact. The court of appeals again committed a second error to offset what it perceived to be a first error.

What emerges out of the Tax Court's error is the transsubstantiation of the dictum of *Mayfair Minerals* into what the Commissioner sees as the rule of the Tax Court's decision in this

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[18] *1 Bittker, supra*, Fn. 16, para. 5.7.2, p. 5-53.

[19] Taxpayers are flexible. What may follow the rejection of the exception has been previewed in *Twitchco, Inc., supra*, Fn 1, where the taxpayer unsuccessfully sought to sustain a deduction on the argument that it made little difference whether the deduction was proper or improper. The district court, relying upon *Canelo*, rejected the taxpayer's argument that if the deduction later proved to be erroneous, correction could later be made under the tax benefit rule.

[20] See *Bishop*, 51 J. Tax at 284. In the decisions that have followed the decision in this case, the Tax Court has not interpreted its decision as a rejection of the exception. See *Garner v. Commissioner*, TC Memo. 1981-542 (1981); *Davis v. Commissioner*, 74 TC 881 (1980); *Shed v. Commissioner*, TC Memo 80-384 (1980); and *Southern Pacific Transportation Co.*, 75 TC 497 (1980).

case. The way of the Commissioner is now clearly charted in *Revenue Ruling* 81-208, when he states that the Tax Court's decision in this case establishes the principle that "the taxpayers have a duty of consistency that 'precludes a taxpayer who has received a tax benefit due to his treatment of an item in a year barred by the statute of limitations from claiming that the original treatment was incorrect and thus obtaining a tax advantage in a later year.' "[21]

What emerges out of the error of the court of appeals is appellate affirmance of the way of the Commissioner and his attempts to prevent a taxpayer, after taking a position in one year to his advantage and after correction of that year is barred, from shifting to a contrary position touching the same fact or transaction. This transactional correction of *"all"* taxpayer error to produce a unitary result is the more fundamental issue in this case.

The unraveling of judicial precedent, which commences in this case, continues in *Revenue Ruling* 81-208 with the Commissioner's rejection of the Tax Court's decisions in *B.C. Cooke & Sons, Inc., supra,* Fns. 1 and 2. If the domino effect of the rejection of the exception, and, in turn, of the "double deduction" of *B.C. Cooke & Sons,* continues to its ultimate conclusion,

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[21] 1981-35 I.R.B.6. In *Mayfair Minerals* the taxpayer's erroneous deductions were early discovered, if not known at the outset. The taxpayer, knowing of the errors before the statute ran on the years of the erroneous deductions, nevertheless did not file an amended return. See Fns 3 and 15. Yet, in *Mayfair Minerals,* the court stated that: "Petitioner's treatment of this item on its tax returns *misled* the revenue agents, and it does not matter whether this was done deliberately or *unintentionally* (emphasis added)". 56 TC at 88. While the taxpayer's misrepresentation seems clear enough, nowhere does the court indicate that the Commissioner relied upon the misrepresentation or that the Commissioner was otherwise misled by the taxpayer. Innocent or unintentional misrepresentation is not the equivalent of intentional misrepresentation. Mere acceptance or receipt of a tax return when filed, without more, is not the equivalent of actual reliance on the representations contained in that return. "Misrepresentation" and "reliance" are therefore but two more terms to be included in the list of legal jacks-of-all-trades that make quasi-estoppel in tax matters.

all that will remain is a one-shot statute of limitations, one that will be applied with an uneven hand to the advantage of the Commissioner, and one that will prohibit correction of taxpayer error only if the item does not reappear (is not "recovered") in some fashion in a later year. Such a weakened statute warrants the present consideration by this Court.

CONCLUSION

The Petition for Writ of Certiorari should be granted.

Respectfully submitted,

DONN KEMBLE

January, 1982

Appendix

APPENDIX A

72 T.C. No. 70

United States Tax Court

ALLEN D. UNVERT AND CATHERINE R. UNVERT,
Petitioners

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent

Docket No. 8690-76.

Filed August 8, 1979.

In his income tax return for 1969, petitioner deducted $54,500 as interest paid on indebtedness incurred to purchase real property. In 1972, the interest payment was refunded. After the statute of limitations on assessments for 1969 had run, respondent determined that the refund was taxable to petitioner in 1972.

Held, in the light of all the facts, petitioner had a duty to treat the transaction consistently in both 1969 and 1972, and the interest refund is taxable in the latter year under the tax benefit rule.

Donn Kemble and *Joseph LaTorre,* for the petitioners.
Kenneth G. Gordon, for the respondent.

FEATHERSTON, *Judge:* Respondent determined a deficiency of $44,405 in petitioners' Federal income tax for 1972. The issue for decision is whether $54,500 received in 1972 as a refund of prepaid interest which was claimed and allowed as a deduction in petitioners' 1969 income tax return is taxable in the later year.

FINDINGS OF FACT

Petitioners Allen D. Unvert and Catherine R. Unvert, husband and wife,[1] were legal residents of Newport Beach, California, at the time their petition was filed. They filed their joint Federal income tax return for 1972 with the District Director of Internal Revenue for the District of Los Angeles, Fresno, California.

Petitioner Allen D. Unvert (petitioner) is a physician. In late 1969, concerned about the rate of taxation on the income from his medical practice, petitioner requested Walter P. Gribben (Gribben), an attorney, to suggest investments which would serve as tax shelters. Gribben referred petitioner to John B. Halverson (Halverson), an acquaintance of both men and a law school classmate of Gribben. In mid-December 1969, petitioner telephoned Halverson, then president of U.S. Financial Corp.,[2] and Halverson told petitioner he would make inquiries on the latter's behalf. Having heard nothing further from Halverson, petitioner again telephoned him on December 30, 1969. They agreed to meet the next day in San Diego to discuss an investment opportunity.

On the afternoon of December 31, 1969, petitioner met with Halverson as well as with Robert M. Walters, a founder and the chairman of the board of U.S. Financial Corp., and David G. Leaverton (Leaverton), house counsel. He was informed of an opportunity to purchase 16 condominium units in a large building owned by U.S. Financial Corp.; these units were identified on a list shown petitioner at the meeting. The

[1] Petitioners were married in 1972.

[2] Petitioners have asked us to take judicial notice under Rule 201, Federal Rules of Evidence, of several newspaper articles concerning U.S. Financial Corp. In our view, these articles, set out in Appendix I to petitioner's brief, contain no material relevant to the U.S. Financial Corp. transaction at issue here. Accordingly, we decline to take judicial notice of them.

representatives of U.S. Financial proposed that petitioner purchase the units on a contract of sale. The amount of the purchase price would be loaned petitioner by U.S. Financial.[3]

According to U.S. Financial, it was anticipated that most of the units would be sold during the following year. Sales prices were expected to be in an aggregate amount which would exceed the sales price to petitioner, thus enabling him to pay off the loan to U.S. Financial and to realize a profit as well.

Petitioner was informed that by writing a check for prepaid interest on the loan, he would secure an interest deduction for 1969. Petitioner agreed to these terms. At the meeting, petitioner gave the others a personal check in the amount of $54,500 payable to U.S. Mortgage. On the check he indicated that the payment was to serve as prepaid interest on the loan of the purchase price of the condominiums. He was given a receipt for the payment.[4] Due to the late hour of the meeting, the representatives of U.S. Financial informed petitioner that the various documents related to the transaction could not be prepared until the following year. Petitioner made no objection and left the meeting with the belief that he had entered into a contract for the purchase of the condominium units.

During March 1970, petitioner became concerned that he had received no documentation of the condominiums purchase from U.S. Financial. He was reassured by Gribben that the documentation would be forthcoming and by John Leventis (Leventis), petitioner's accountant, that his check was adequate proof of the existence of the contract. To compute depreciation, Leventis telephoned U.S. Financial to confirm the purchase

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[3] Apparently, related companies were to be involved in aspects of the transaction—Swan Constructors, Inc., in the sale, and U.S. Mortgage in the loan. We will for the most part refer to U.S. Financial rather than to the other companies.

[4] The parties have stipulated that petitioner was given a receipt. At trial, without objection, petitioner testified that he was given no receipt and that he believed the canceled check would serve as one.

price. On his tax return for 1969, petitioner deducted as prepaid interest $54,500 and as depreciation on the units $1,239.58.

Having made several telephone calls to representatives of U.S. Financial to request the documents relating to the purchase, petitioner wrote Halverson a letter dated April 23, 1970, in which he expressed his concern at the delay in receiving documents "regarding the contractual relation we entered at the end of 1969." He asked for information and proposed a meeting to resolve possible difficulties. Under cover of a letter dated June 16, 1970, Leaverton forwarded to petitioner copies "of the proposed documentation." By a letter dated December 23, 1970, Gribben suggested that Halverson meet with petitioner about the "substantial amount of documentation remaining to be done."

When preparing his 1970 income tax return, petitioner was still concerned at his failure to receive documentation and an accounting of the 1969 transaction. By a letter dated March 24, 1971, he asked Halverson for information and indicated he would be willing to discuss any problems at a meeting. He informed Gribben of this letter by a letter dated the same day. After telephone calls made by petitioner and Leventis yielded no results, the two met with Halverson and Leaverton in mid-1971. At this meeting petitioner was informed that the condominium units had not been sold and that U.S. Financial had not decided how to arrange the bill of sale.

By a letter dated August 9, 1971, Leaverton informed Gribben that:

> My client, Swan Constructors, Inc., hereby agrees to purchase your client Dr. Dale Unvert's position in the above-referenced condominium units on or before December 1, 1971 for the sum of $54,000 cash (less any cash theretofore received by Dr. Unvert by reason of such investment), upon the demand of Dr. Unvert.

In a letter to petitioner dated September 1, 1971, the controller of U.S. Financial, Gary L. Fitzgerald, enclosed a promissory note, a contract of sale and purchase, and a management agreement, which were designed to document the December 31, 1969, transaction. He requested that petitioner execute the documents and return them. He indicated that he would then return "the completely executed documents" to petitioner. In the letter he refers to a letter written by Leaverton to Gribben, apparently that of August 9, 1971, which he terms a "letter of indemnification."

By a letter dated September 20, 1971, Gribben forwarded to Leaverton a promissory note in the amount of $50,000 and an executed copy of the management agreement, both of which were signed by petitioner. As he indicates in the letter, the promissory note is dated December 31, 1969; Gribben states that "it is clear that this Promissory Note evidenced part of the original purchase price." He mentions that he has asked petitioner to sign the contract of sale and purchase agreement, which petitioner "unfortunately neglected to sign." He further refers to Leaverton's statement in the August 9, 1971, letter that Swan Constructors, Inc., would purchase petitioner's interest in the condominiums.

In August or September 1971, petitioner and his accountant met with U.S. Financial's in-house accountant. When informed by the accountant that "the deal [would] be consummated" only if petitioner invested an additional $55,000, petitioner refused. At this point, petitioner asked Gribben to represent him in obtaining a refund of the original investment from U.S. Financial.

Petitioner believed until at least April 15, 1972, that he owned the condominiums. He also believed that during 1970 and 1971 some of the condominiums were leased under the management agreement and that some were sold and others substituted by U.S. Financial. On his 1970 and 1971 income tax returns, he deducted losses connected with the investment.

On or about May 1, 1972, following a series of contacts by Gribben in person, over the telephone, and by letter, which included a threat of legal action, petitioner received a personal check from Walters in the amount of petitioner's December 31, 1969, check. Petitioner informed Leventis of his receipt of the money.

On August 14, 1972, revenue agent Gerald Lenning (Lenning) contacted petitioner concerning an audit of petitioner's 1970 and 1971 income tax returns. On October 11, 1972, Lenning met with Leventis with regard to the audit. At the meeting, Lenning gave Leventis a documented request for additional information about several items on the return, including petitioner's deductions related to U.S. Financial. Despite repeated requests for information, neither petitioner, Leventis, nor Gribben supplied any information to Lenning about the U.S. Financial transaction. Leventis supplied Lenning with information on other items.

On or about June 7, 1973, Lenning first obtained information on the U.S. Financial transaction from the San Diego Office of the Internal Revenue Service. On July 11, 1973, Lenning informed Leventis of his position that petitioner's purchase of the units was never completed. Leventis disagreed with Lenning. Petitioner's representatives did not comply with requests for more information on the transaction submitted by Lenning on July 23, 1973, July 30, 1973, September 28, 1973, and December 21, 1973.[5] In August 1973, Lenning issued to petitioner a Revenue Agent's Report. On or about October 15, 1973, petitioners filed their 1972 income tax return, on which they did not report the $54,000 received in 1972.

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[5] By Sept. 1973, Leventis was no longer serving as petitioner's accountant. Later contacts were with petitioner's attorney, Donn Kemble, and new accountant, Pete Helsley.

OPINION

Because petitioner received a "tax benefit" from the deduction of the $54,500 as interest on his 1969 return, he is, in respondent's view, required to include that amount in his income for 1972, the year in which the deducted amount was refunded to him. Petitioner implicitly concedes that he would be required to include the refund in his 1972 income if the deducted amount in fact represented interest relating to a valid contract to purchase condominium units.[6] Since it subsequently became evident that the condominiums' purchase was never consummated, however, petitioner contends that the 1969 deduction was erroneous and that, consequently, the "tax benefit" rule does not apply. To support this position petitioner relies mainly on *Canelo v. Commissioner,* 53 T.C. 217 (1969), affd. per curiam on other grounds 447 F.2d 484 (9th Cir. 1971) and *Streckfus Steamers, Inc. v. Commissioner,* 19 T.C. 1 (1952.

We hold for respondent.

Although each taxable period is separate and independent, there are situations in which the proper treatment of an item in one year cannot be resolved without reference to events in a prior year. See, e.g., *Dobson v. Commissioner,* 320 U.S. 489 (1943), rehearing denied 321 U.S. 231 (1944). When an amount is deducted from gross income in one year and recovered in a subsequent year, such amount is taxed in the later year if a tax benefit was realized from the deduction. *Merchants Nat. Bank v. Commissioner,* 199 F.2d 657,659 (5th Cir. 1952), affg. 14 T.C. 1375 (1950); *Putnam Nat. Bank v. Commissioner,* 50 F.2d 158 (5th Cir. 1931), affg. 20 B.T.A. 45

[6] Apparently as late as 1975 petitioner contended that the transaction was a valid purchase. It is stipulated that a notice of deficiency was issued on Mar. 18, 1975, to petitioner denying claimed losses for 1970 and 1971 in connection with this transaction, and that a Tax Court case was instituted. Subsequent to the filing of the answer in that case, petitioner conceded that respondent had correctly denied those deductions.

(1930). The reason for this rule is clear, as explained in *Estate of Block v. Commissioner,* 39 B.T.A. 338, 341 (1939), affd. sub nom. *Union Trust Co. v. Commissioner,* 111 F.2d 60 (7th Cir. 1940), cert. denied 311 U.S. 658 (1940):[7]

> When recovery or some other event which is inconsistent with what has been done in the past occurs, adjustment must be made in reporting income for the year in which the change occurs. No other system would be practical in view of the statute of limitations, the obvious administrative difficulties involved, and the lack of finality in income tax liability, which would result.

The instant case is a classic one. Petitioner deducted his 1969 payment to U.S. Financial Corp. as interest, thereby realizing a tax benefit. In 1972, the amount previously deducted was refunded to him. Under the tax benefit rule, the return to him of money which had been the subject of the income tax deduction in the prior year requires that the money be treated as income in the year of recovery.

We think petitioner's reading of *Streckfus Streamers, Inc. v. Commissioner, supra,* and *Canelo v. Commissioner, supra,* is too broad. In *Streckfus Streamers,* the taxpayer, on the accrual basis, claimed and was allowed on its 1940 return a deduction for Illinois sales tax; the taxpayer had not paid the tax and continued to contest it. After the Illinois court held the taxpayer was not liable for the tax, the Commissioner sought unsuccessfully to include in the taxpayer's 1943 gross income a sum equal to the 1940 deduction. Similarly, in *Canelo,* the taxpayers, members of a cash basis law partnership, deducted litigation

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[7] While the tax benefit rule had its genesis in court decisions, it is now implicitly codified in sec. 111, I.R.C. 1954, relating to recovery exclusions. *West Seattle National Bank of Seattle v. Commissioner,* 288 F.2d 47, 48-49 (9th Cir. 1961), affg. 33 T.C. 341 (1959).

expenses advanced under reimbursement agreements signed by their clients. The court held that the advanced expenses were loans and were not deductible for years not barred by limitations. It refused to allow the Commissioner to include in current income reimbursements received by the taxpayers for advances made and deducted in earlier barred years. Because the deductions were improper when taken, the court held that the tax benefit rule did not apply.

In those cases, the taxpayer did not switch the position taken in the year for which the deduction was allowed. The taxpayer in *Streckfus Streamers* claimed the deduction for 1940, and it was allowed by mutual mistake. After the Illinois court held the taxpayer did not owe the deducted tax and the Supreme Court clarified the law on timing of the deduction for contested liabilities,[8] the Commissioner switched his position and sought to include the deducted amount in income for a later year. Similarly, in *Canelo,* the taxpayer contended even at the time of trial, that the advanced legal expenses were deductible in the year in which they were incurred.

In contrast, petitioner claimed the $54,500 deduction on his 1969 return and thus declared that he had paid that amount as interest in 1969. The representation was accepted by the Internal Revenue Service as true, and the 1969 deduction was not disallowed. But now petitioner has shifted his position. He maintains that the payment was not interest, in effect claiming that the declaration in his 1969 return was untrue. Since the Internal Revenue Service did not notice his mistake before the statute of limitations expired, petitioner argues that no adjustment can be made with respect to the erroneously claimed interest deduction either for 1969, the year of the deduction, or for 1972, the year in which he received the refund.[9]

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[8] *Security Mills Co. v. Commissioner,* 321 U.S. 281 (1944); *Dixie Pine Co. v. Commissioner,* 320 U.S. 516 (1944).

[9] Although the record is not entirely clear on this point, the refund could be interpreted as constituting a rescission of a valid contract. If so, the initial deduction was not erroneous and the tax benefit rule would clearly apply.

Because "it is no more right to allow a party to blow hot and cold as suits his interest in tax matters than in other relationships," courts have held a taxpayer to a duty of consistency in his tax treatment of related items.[10] *Alamo Nat. Bank v. Commissioner,* 95 f.2d 622, 623 (5th Cir. 1938), affg. 36 B.T.A. 402 (1937), cert. denied 304 U.S. 577 (1938). The duty of consistency precludes a taxpayer who has received a tax benefit due to his treatment of an item in a year barred by the statute of limitations from claiming that the original treatment was incorrect and thus obtaining a tax advantage in a later year. Disapproving of such a shift of position on the part of the taxpayer before it, the Fifth Circuit has observed *(Johnson v. Commissioner,* 162 F.2d 844, 846 (5th Cir. 1947)):

> This court has several times held that when a transaction and its tax consequences are thus projected into other tax years there is a duty of consistency as to its treatment, and one should be held to the consequences of the initial treatment, *though inaccurate,* when a correction throughout is impossible. [Emphasis added.]

This doctrine applies "even though all the technical elements of estoppel are not present." *Continental Oil Co. v. Jones,* 177 F.2d 508, 512 (10th Cir. 1949), cert. denied 339 U.S. 931 (1950). Accord *Orange Securities Corp. v. Commissioner,* 131 F.2d 662, 663 (5th Cir. 1942). The Eighth Circuit has recently enumerated the prerequisites for application of the doctrine, also termed "quasi-estoppel," as follows (*Beltzer v. United States,* 495 F.2d 211, 212 (8th Cir. 1974)):

> (1) the taxpayer has made a representation or reported an item for tax purposes in one year,

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[10] On Jan. 2, 1979, respondent filed a Motion for Leave to File Amended Answer to Conform the Pleadings to the Proof, under Rule 41(b), Tax Court Rules of Practice and Procedure. The motion requested leave to amend the pleadings to reflect the doctrine of quasi-estoppel or duty of consistency. Upon due consideration, we find that the issue has been tried by the consent of the parties. Accordingly, we have granted respondent's motion to amend the pleadings.

(2) the Commissioner has acquiesced in or relied on that fact for that year, and

(3) the taxpayer desires to change the representation, previously made, in a later year after the statute of limitations on assessments bars adjustments for the initial tax year.

See also *Hess v. United States*, 537 F.2d 457, 463 (Ct. Cl. 1976), cert. denied 430 U.S. 931 (1977), which applies the three elements laid out in *Beltzer*.[11]

Relying on this doctrine, certain cases have applied the tax benefit rule to a taxpayer who erroneously claimed a deduction in one year, recovered the amount of that deduction in a later year, and then shifted his position in the later year as to the controlling facts. See *Askin & Marine Co. v. Commissioner*, 66 F.2d 776, 778 (2d Cir. 1933), affg. 26 B.T.A. 409 (1932), and *Commissioner v. Liberty Bank & Trust Co.*, 59 F.2d 320, 325 (6th Cir. 1932), revg. & remg. 14 B.T.A. 1428 (1929) (debts charged off as worthless in an earlier year and collected in a later year); *Mayfair Minerals, Inc. v. Commissioner*, 56 T.C. 82 (1971), affd. per curiam 456 F.2d 622 (5th Cir. 1972) (refunds ordered by Federal Power Commission deducted as accrued liabilities and order later rescinded); *Faidley v. Commissioner*, 8 T.C. 1170, 1173 (1947) (loss claimed in an earlier year and recovered from the estate of a guarantor in a later year).

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[11] In contrast, for the more stringent requirements of "pure" estoppel to apply (*United States v. S.F. Scott & Sons*, 69 F.2d 728, 732 (1st Cir. 1934)

(1) there must be false representation or wrongful misleading silence. (2) The error must originate in a statement of fact and not in an opinion or a statement of law. (3) The person claiming the benefits of estoppel must be ignorant of the true facts, and (4) be adversely affected by the acts or statements of the person against whom an estoppel is claimed.

Accord *Tide Water Oil Co. v. Commissioner*, 29 B.T.A. 1208, 1218-1219 (1934).

In a number of other contexts, courts have refused taxpayers benefits from treating items in a manner inconsistent with that of barred years. E.g., *Robinson v. Commissioner*, 181 F.2d 17 (5th Cir. 1950), affg. 12 T.C. 246 (1949) (amount erroneously deducted in barred year could not be deducted in later year); *Wichita Coca Cola Bottling Co. v. United States*, 152 F.2d 6 (5th Cir. 1945), cert. denied 327 U.S. 806 (1946) (income omitted in barred year taxed in later year); *Bothwell v. Commissioner*, 77 F.2d 35 (10th Cir. 1935), affg. 27 B.T.A. 1351 (1933) (failure to report fair market value of property received as compensation prevented use of such value as basis); *Griffith v. United States*, an unreported case (N.D. Tex. 1971, 27 AFTR2d 754, 71-1 USTC par. 9280) (value of property reported on estate tax return by taxpayer as administratrix held basis for computing gain on disposition).

Petitioner acknowledges this line of cases but argues that they apply only to those he deems "bad guys"; he maintains that his behavior has been innocent. We are not persuaded by this argument.[12] The cases cited by petitioner do not support his position that a taxpayer who innocently misrepresented a fact in a barred year may freely switch his position to achieve a tax advantage in a later year. *These cases rely in part on other factors, such as the availability of the true facts to the Commissioner during the period before the statute of limitations ran. Ross v. Commissioner*, 169 F.2d 483, 495-496 (1st Cir. 1948), revg. a Memorandum Opinion of this Court; *Studebaker-Packard Corp. v. United States*, an unreported case (N.D. Ind.

[12] In *Mayfair Minerals, Inc. v. Commissioner*, 56 T.C. 82, 91 (1971), affd. per curiam 456 F.2d 622 (5th Cir. 1972), we stated that *Canelo v. Commissioner*, 53 T.C. 217 (1969), affd. per curiam 447 F.2d 484 (9th Cir. 1971) and *Streckfus Streamers, Inc. v. Commissioner*, 19 T.C. 1 (1952)—

> are clearly inapposite where the taxpayer, *either deliberately or unintentionally*, misleads the Commissioner through erroneous representations of fact in his returns, and the Commissioner, consequently, allows the statute of limitations to run on adjustments of taxable income on the misleading returns. [Emphasis added.]

1961, 61-2 USTC par. 9551, 8 AFTR2d 5058). Another case notes, in addition to this factor, that the erroneous deduction at issue resulted from a mistake of law. *Crosley Corp. v. United States,* 229 F.2d 376, 381 (6th Cir. 1956). It is well settled that estoppel does not apply to mistakes of law, see *United States v. S. F. Scott & Sons,* 69 F.2d 728 (1st Cir. 1943), but before a mistake of law can occur both parties must know the facts. *Mayfair Minerals v. Commissioner,* 56 T.C. at 93.

Other cases are inapposite in that they involve a change of position not by the taxpayer but by the Commissioner. *Commissioner v. Schuyler,* 196 F.2d 85 (2d Cir. 1952), affg. a Memorandum Opinion of this Court; *Twitchco, Inc. v. United States,* 348 F.Supp. 330 (M.D. Ala. 1972). In another, the Commissioner apparently did not rely on the doctrine of quasi-estoppel. *B. C. Cook & Sons, Inc. v. Commissioner,* 59 T.C. 516 (1972). In the final case upon which petitioner relies, the taxpayer did not switch his position after an earlier year was barred but rather urged than an erroneous deduction be allowed for the year at issue on the grounds that the Commissioner could later rely on the tax benefit rule and include the amount in income. *LaCroix v. Commissioner,* 61 T.C. 471 (1974).

Even assuming the duty of consistency or quasi-estoppel does not apply to the innocent, we are not persuaded by petitioner's protestations of what he terms his "pure heart." He claims his belief that the 1969 transaction constituted a valid contract lasted until after April 15, 1973, when the statute of limitations for 1969 expired. He was shaken in this belief, he asserts, only in August 1973, when he read Lenning's report which stated that the sale of the condominiums was never completed. Upon receiving the May 1972 check for $54,500, petitioner, according to his varying accounts, either did not think of the tax consequences, or believed that the check represented part of the sale price to Swan Constructors, Inc., and that it would therefore be reported on his 1972 return, or

continued to believe that he still owned the condominiums. He explains his failure to report the amount on his 1972 income tax return as due to his realization, after the statute of limitations for his 1969 return had run but before he filed his 1972 return on October 15, 1973, that he had not in fact owned the condominiums.

We find petitioner's statements inconsistent, both internally and with his contemporaneous actions. We find it incredible that upon merely reading Lenning's report, petitioner would abandon his long-held belief that the 1969 transaction constituted a valid contract. As one of the parties involved, he had knowledge of facts which Lenning lacked. Moreover, at the time petitioner now claims he realized there had been no contract, Leventis was disputing this finding with Lenning. Petitioner failed to include the $54,500 amount on his 1972 return, an action consistent only with the very position advanced by Lenning which petitioner and his representatives were then disputing.

As to his view of the May 1972 check, we are unable to determine among his spate of accounts what petitioner did in fact think. We note, however, that the view that the refund was a sale, one which petitioner concededly did not advance on his 1972 return, appears unreasonable. At one point, he states that he viewed the check as carrying out the August 1971, offer to but his position in the condominiums. Yet the offer was made months earlier and there is nothing to indicate that the May 1972, transaction was intended to carry out that offer. Moreover, his instructions to Gribben "to get * * * [the] money back" are inconsistent with a theory of sale.

In light of petitioner's repeated earlier references to his belief in the existence of a contract and the lack of evidence that the 1969 payment was a deposit, we think petitioner was attempting to retrieve not a deposit but rather an amount paid for which petitioner had belatedly discovered that a contract might not exist. If petitioner believe no contract existed in May

1972, he was under the duty prescribed by section 1.461-1(a)(3)(i), Income Tax Regs., to file an amended return. Even if he was unaware of this duty, he was aware of the audit of his 1970 and 1971 returns. Yet his representatives repeatedly withheld from Lenning information in regard to the U.S. Financial Corp. transaction. A taxpayer may be charged with responsibility for actions involving his income tax returns which he has entrusted to his accountant. *Bartel v. Commissioner,* 54 T.C. 25, 30-31 (1970). Therefore, even if petitioner was innocent at the time of filing the 1969 return, we think his actions from at least August 1972, to April 15, 1973, when the 3-year statute of limitations ran on the assessment of a deficiency for 1969, constituted wrongful misleading silence as to the treatment of the condominiums transaction on his 1969 return.

To reflect the foregoing,

Decision will be entered for the respondent.

APPENDIX B

Allen P. UNVERT and Catherine R. Unvert, Appellants,

v.

COMMISSIONER OF INTERNAL REVENUE, Appellee.

No. 79-7602.

United States Court of Appeals,
Ninth Circuit.

Argued and Submitted Aug. 4, 1981.

Decided Sept. 14, 1981.

Taxpayers appealed from decision of the United States Tax Court, 72 Tax Ct. 807, holding that money paid toward purchase of condominiums in 1969 and deducted as an interest expense in that year was to be treated as income under tax benefit rule when recovered in 1972. The Court of Appeals, Eugene A. Wright, Circuit Judge, held that recovery of the expense was required to be treated as income under the tax benefit rule regardless of whether the 1969 deduction had been improper.

Affirmed.

1. Internal Revenue—325

The "tax benefit rule" is a judicially created doctrine providing that a taxpayer who deducts an expenditure in one year resulting in a reduction of taxable income must include in income any recovery of that expenditure in a later year.

See publication Words and Phrases for other judicial constructions and definitions.

2. Federal Courts—759

Court of Appeals may affirm on any basis squarely presented by the record.

3. Internal Revenue—1404

Inclusion of recovery of previously deducted expenditure as income does not reopen tax liabillity for the prior year and does not implicate statute of limitations.

4. Internal Revenue—325

Recovery of a previously deducted expenditure must be taxed because it previously created a tax benefit, not because of inherent characteristic of the recovery.

5. Internal Revenue—325

Regardless of whether original deduction of interest expenditure was improper subsequent recovery of the expenditure was required to be treated as income in the year of recovery under the tax benefit rule.

Appeal from the United States Tax Court.

Before WRIGHT, SCHROEDER, and ALARCON, Circuit Judges.

EUGENE A. WRIGHT, Circuit Judge:

Taxpayers appeal from a decision of the Tax Court holding that money paid toward the purchase of condominiums in 1969 and deducted as an interest expense in that year must be treated as income under the tax benefit rule when recovered in 1972. The taxpayers contend that the erroneous deduction exception to the tax benefit rule applies. We affirm.

FACTS

On December 31, 1969, Allen Unvert paid $54,500 to U.S. Financial Corp. towards the purchase of condominiums. He was told that the payment represented deductible prepaid interest and that the paperwork regarding the purchase would be completed in March 1970. Unvert deducted the $54,500 for calendar year 1969 as an interest expense.

Unvert claimed additional operating expense deductions in 1970 and 1971, although he was never given any documents reflecting the terms of the purchase. In June 1971, he requested the documents from U.S. Financial. In May 1972, it agreed to return without interest the $54,500 paid in December 1969.

Unvert obtained an extension of time until October 15, 1973, to file his 1972 return but did not then include as income the funds returned by U.S. Financial. The statute of limitations on the 1969 return ran on April 15, 1973. In August 1973, the IRS concluded an audit of Unvert's 1970 and 1971 returns, recommending that the condominium-related expenses be disallowed because Unvert was never the legal owner of the condominiums.

In June 1976, the Commissioner issued a notice of deficiency for 1972 of $44,405, on the basis that the $54,500 recovered in 1972 was taxable income under the tax benefit rule. Unvert petitioned to contest the deficiency in the Tax Court, which held for the Commissioner. *Unvert v. Commissioner,* 72 T.C. 807 (1979).

DISCUSSION

[1] The tax benefit rule is a judicially created doctrine providing that a taxpayer who deducts an expenditure in one year resulting in a reduction of taxable income must include in income any recovery of that expenditure in a later year. *See National Bank of Commerce v. Commissioner,* 115 F.2d 875, 877 (9th Cir. 1940); Bittker and Kanner, *The Tax Benefit Rule,* 26 U.C.L.A.L.Rev. 265 (1978).

Unvert challenges application of the rule in the present case on the basis of Tax Court cases holding that it does not apply where the original deduction was improper. *See Streckfus Steamers, Inc. v. Commissioner,* 19 T.C. 1 (1952); *Canelo v. Commissioner,* 53 T.C. 217, 226-27 (1969), *aff'd on other grounds,* 477 F.2d 484 (9th Cir. 1971) (issue not raised in taxpayer's appeal).

The Tax Court held that *Streckfus* and *Canelo* were distinguishable from the present case because in neither had the taxpayer changed his position with respect to the propriety of the earlier deduction. The court held that Unvert had a duty of consistency and was estopped from contending that the deduction he had previously claimed was improper. *Unvert*, 72 T.C. at 813-16. Unvert contends that the present case is indistinguishable from *Streckfus* or *Canelo* and that he was guilty of no misrepresentation justifying estoppel.

[2] Because we affirm on the basis that the erroneous deduction exception should be rejected, we do not consider the Tax Court's estoppel theory.[1]

The logic of the erroneous deduction exception is that an improper deduction should be corrected by assuming a deficiency before the statute of limitations has run, not by treating recovery of the expenditure as income. This rationale was explained most comprehensively in *Canelo:*

> We realize that petitioners herein have received a windfall through the improper deductions. But the statute of limitations requires eventual repose. The "tax benefit" rule disturbs that repose only if respondent [the Commissioner] had no cause to question the initial deduction, that is, if the deduction was proper at the time it was taken. Here the deduction was improper, and respondent should have challenged it before the years prior to 1960 were closed by the statute of limitations.

53 T.C. at 226-27.

[3] We find this unpersuasive. Prior decisions under the tax benefit rule state clearly that inclusion of the recovery as income does not reopen the tax liability for the prior year and does not implicate the statute of limitations.

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[1] This court may affirm on any basis squarely presented by the record. *See Shipley v. United States*, 608 F.2d 770, 773-74 (9th Cir. 1979).

> Income tax liability must be determined for annual periods on the basis of facts as they existed in each period. When recovery or some other event which is inconsistent with what has been done in the past occurs, adjustment must be made in reporting income for the year in which the change occurs. No other system would be practical in view of the statute of limitations, the obvious administrative difficulties involved, and the lack of finality in income tax liability, which would result.

First Trust & Savings Bank v. United States, 614 F.2d 1142, 1145 (7th Cir. 1980) quoting *Block v. Commissioner,* 39 B.T.A. 338 (1939) (emphasis omitted)). *Accord, Rosen v. Commissioner,* 611 F.2d 942, 944 (1st Cir. 1980); *Munter v. Commissioner,* 63 T.C. 663, 678—79 (1975) (Tannenwald, concurring); Bittker, 26 U.C.L.A.Rev. at 267—72. In holding that the tax benefit rule required inclusion of recovery only to the extent the deduction, resulted in a tax saving in the prior year, the Supreme Court noted:

> The Tax Court has not attempted to revise liability for earlier years closed by the statute of limitation, nor used any expense, liability, or deficit of a prior year to reduce the income of a subsequent year. It went to prior years only to determine the nature of the recovery, whether return of capital or income. Nor has the Tax Court reopened any closed transaction; it was compelled to determine the very question whether such a recognition of loss had in fact taken place in the prior year as would necessitate calling the recovery in the taxable year income rather than return of capital.

Dobson v. Commissioner, 320 U.S. 489, 493, 64 S.Ct. 239, 242, 88 L.Ed. 248 (1943).

Unvert attempts to provide a more fully reasoned justification for this exception. He argues that whether the recovery of a previous expenditure is taxable depends on its character as

income or a return of capital. This character, he contends, is determined from the inherent characteristics of the transaction, not whether the taxpayer originally deducted the expenditure. *See* Bishop, *The Tax Benefit Rule After Unvert: Does it Compromise the Statute of Limitations,* 51 J.Tax 272, 273 (1979). The Commissioner does not contest that the 1969 deduction was improper because the expenditure was capital. Unvert argues that the Commissioner has attempted to recoup the 1969 deduction by improperly recharacterizing the recovery as income rather than correctly treating it as a nontaxable return of capital.

[4] This argument is unpersuasive. The decisions creating and applying the tax benefit rule make clear that the recovery must be taxed because it previously created a tax benefit, not because of the inherent characteristic of the recovery.

> [T]o the extent of deductions taken, a debt loses its nature as capital and takes on the character of the untaxed income which the deduction represents.

West Seattle National Bank v. Commissioner, 288 F.2d 47, 49 (9th Cir. 1961); *accord, National Bank of Commerce v. Commissioner,* 115 F.2d 875,876—77 (9th Cir. 1940).

[5] The erroneous deduction exception is also poor public policy. A taxpayer who properly claims a deduction for an expenditure that is recovered in a later year must treat the recovery as income, while one who claims an improper deduction may not be required to include the recovery as income only because of the impropriety of the deduction. We agree with the Second Circuit that improperly taken tax deductions should not be rewarded.

> We need in this case to concern ourselves with the theory advanced that when . . . a deduction has improperly been claimed and allowed, no part of such deduction when collected can be included in income. It is obvious that if this is so a taxpayer who gets an unlawful deduction

> in this way not only cuts down his taxable income in the year the deduction is taken, but gets immunity from income taxation on the account receivable which was deducted whenever it, or any part of it, is received. A result so unjust is not to be reached unless plainly required by law.

Askin & Marine Co. v. Commissioner, 66 F.2d 776, 778 (2d Cir. 1933) (court avoided erroneous deduction exception through estoppel theory).

At least three circuits have implicitly rejected or criticized the erroneous deduction exception. *See Union Trust Co. v. Commissioner*, 11 F.2d 60, 61 (7th Cir.), *cert. denied*, 311 U.S. 658, 61 S.Ct. 12, 85 L.Ed. 421 (1940); *Kahn v. Commissioner*, 108 F.2d 748, 749 (2d Cir. 1940); *Askin & Marine Co. v. Commissioner*, 66 F.2d 776, 778 (2d Cir. 1933); *Commissioner v. Liberty Bank & Trust Co.*, 59 F.2d 320, 325 (6th Cir. 1931).

AFFIRMED.[2]

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[2] As noted previously, the Tax Court held that the erroneous deduction exception did not apply on the basis that the taxpayer was estopped from claiming that the prior deduction was improper. *Unvert*, 72 T.C. at 813-16. We do not decide whether that approach was a sufficient basis to find for the Commissioner. We believe the Tax Court's approach is inferior to rejecting the erroneous deduction exception outright because it would involve courts in more complex case-by-case adjudication.

The Tax Court held that a taxpayer is estopped by deliberate or unintentional misrepresentations of *fact*. The Taxpayer is invited to argue that the mistake upon which the deduction was based was one of law. *Id.* at 816.

The principal case relied upon by the Tax Court suggests also that the taxpayer could argue that the IRS should have known the deduction was improper. *See Mayfair Minerals, Inc. v. Commissioner*, 56 T.C. 82, 89-91 (1971), *aff'd per curiam*, 456 F.2d 622 (5th Cir. 1972).

It may be open to debate whether it is the taxpayer or the Commissioner who has changed position. *See* Bishop, 51 J.Tax at 274.

Finally, if the erroneous deduction exception is retained in any form, there always will be inquiry as to whether the original deduction was erroneous. In this sense, the erroneous deduction exception actually undermines the policies of the statute of limitations.

APPENDIX C

OFFICE OF THE CLERK
UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

NOTICE OF ENTRY OF JUDGMENT

Judgment was entered in this case as of the file stamp date on the attached decision of the court. If the decision is by opinion, judgment was entered as of the decision date printed on the slip opinion.

Petition for Rehearing (FRAP 40)

A petition for rehearing may be filed within 14 days from the entry of judgment. A petition should not be filed in order to reargue the case but should only be filed to direct attention to material facts of law possibly overlooked in the decision. The 15 page limit allowed by the rule must be observed. In addition, 3 copies of the petition are required unless the petition includes a suggestion for rehearing en banc (in such instances 24 copies are required in addition to the original). The petition should of course be directed to the Clerk of the Court. A petition for rehearing must be submitted on 8½ × 11 inch paper, must show complete proof of service to all parties, and the original must contain an original signature of the counsel/pro per litigant submitting the petition.

Bill of Costs (FRAP 39)

See Rule 39 of FRAP for information as to which party is allowed costs on appeal. If a party is allowed costs, the bill of costs must be filed within 14 days from the entry of judgment. Objections to the bill of costs by an adversary party must be filed within 7 days thereafter (see attached form).

Issuance of the Mandate (FRAP 41)

The mandate is the certified copy of the judgment. The mandate is scheduled to be issued 21 days from the entry of judgment unless the court directs otherwise. A *timely* petition for rehearing will stay the issuance of the mandate. If the petition is denied, the mandate will be entered 7 days later. A direct motion for stay of mandate must be filed in an original plus three copies.

Petition for Writ of Certiorari

For information concerning the filing of this petition, refer to the Rules of the Supreme Court of the United States. Appointed counsel should refer to Section 4(c) of the Appendix to the Rules of the United States Court of Appeals for the Ninth Circuit with regard to the obligation to file a petition for certiorari.

APPENDIX D

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

ALLEN D. UNVERT and CATHERINE R. UNVERT,
Appellants,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Appellee.

FILED

NOV. 6, 1981

CLERK,
U.S. COURT OF APPEALS

No. 79-7602

ORDER

Before: WRIGHT, SCHROEDER and ALARCON,
Circuit Judges.

The panel as constituted in the above case has voted to deny the petition for rehearing, and to reject the suggestion for a rehearing en banc.

The full court has been advised of the suggestion for an en banc hearing, and no judge of the court has requested a vote on it. Fed. R. App. P. 35(b).

The petition for rehearing is denied and the suggestion for a rehearing en banc is rejected.

APPENDIX E

INTERNAL REVENUE CODE OF 1954 (26 U.S.C.) :

SECTION 111. RECOVERY OF BAD DEBTS, PRIOR TAXES, AND DELINQUENT AMOUNTS.

(a) *General Rule.* —Gross income does not include income attributable to the recovery during the taxable year of a bad debt, prior tax, or delinquency amount, to the extent of the amount of the recovery exclusion with respect to such debt, tax, or amount.

(b) *Definitions.* —For purposes of subsection (a)—

(1) *Bad Debt.* —The term "bad debt" means a debt on account of worthlessness of which a deduction was allowed for a prior taxable year.

(2) *Prior Tax.* —The term "prior tax" means a tax on account of which a deduction or credit was allowed for a prior taxable year.

(3) *Delinquency Amount.* —The term "delinquency amount" means an amount paid or accrued on account of which a deduction or credit was allowed for a prior taxable year and which is attributable to failure to file return with respect to that tax, or pay a tax, within the time required by the law under which the tax is imposed, or to fail to file return with respect to a tax or pay a tax.

(4) *Recovery Exclusion.* —The term "recovery exclusion", with respect to a bad debt, prior tax, or delinquency amount, determined in accordance with regulations prescribed by the Secretary, of the deductions or credits allowed, on account of such bad debt, prior tax, or delinquency amount, which did not result in a reduction of the taxpayer's tax under this subtitle (not including the accumulated earnings tax imposed by section 531 or the tax on personal holding companies by section 541) or corresponding provisions of prior income tax laws (other than subchapter E of chapter 2 of the Internal Revenue Code of 1939, relating to World War II excess profits tax), reduced by the amount excludable in previous taxable years with respect to such debt, tax, or amount under this section.

INTERNAL REVENUE CODE OF 1954 (26 U.S.C.) :

SECTION 6501. LIMITATION ON ASSESSMENT AND COLLECTIONS

(a) *General Rule.* —Except as otherwise provided in this section, the amount of any tax imposed by this title shall be assessed within 3 years after the return was filed (whether or not such return was filed on or after the date prescribed) or, if the tax is payable by stamp, at any time after such tax became due and before the expiration of 3 years after the date on which any part of such tax was paid, and no proceeding in court without assessment for collection of such tax shall be begun after the expiration of such period.

Opposition

Office - Supreme Court, U.S.
FILED
APR 7 1982
L. STEVAS.

No. 81-1467

In the Supreme Court of the United States

OCTOBER TERM, 1981

ALLEN D. UNVERT AND CATHERINE R. UNVERT,
PETITIONERS

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

MEMORANDUM FOR THE RESPONDENT IN OPPOSITION

REX E. LEE
Solicitor General
Department of Justice
Washington, D.C. 20530
(202) 633-2217

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In the Supreme Court of the United States

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ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

MEMORANDUM FOR THE RESPONDENT IN OPPOSITION

The question presented in this federal income tax case is whether petitioner realized income under the tax benefit rule when money he had paid and deducted as prepaid interest in 1969 was returned to petitioner in 1972.

The pertinent facts may be summarized as follows: On December 31, 1969, petitioner[1] paid $54,500 to U.S. Financial Corporation towards the purchase of condominiums. He was told that the payment represented deductible prepaid interest and that paperwork regarding the purchase would be completed in March, 1970. On his federal tax return for 1969, petitioner deducted the $54,500 as an

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[1]References to petitioner are to Allen D. Unvert. Catherine R. Unvert is a party solely because she filed a joint return with her husband for the taxable year at issue.

interest expense (Pet. App. B2). Petitioner claimed additional operating expense deductions in 1970 and 1971, although he was never given any documents reflecting the purchase. The purchase failed to materialize and in May, 1972, U.S. Financial returned to petitioner, without interest, the $54,500 which he had paid in December, 1969 (Pet. App. B3).

The statute of limitations on the 1969 return expired on April 15, 1973. Petitioner did not file his 1972 return until October 15, 1973 (on extension), and did not include as income the funds returned by U.S. Financial. In August of 1973, after an audit of petitioner's 1970 and 1971 returns, the Commissioner of the Internal Revenue determined that petitioner's claimed expenses relating to the condominiums be disallowed because he was never the legal owner of the condominiums (Pet. App. B3).

Subsequently, the Commissioner determined that the $54,500 that petitioner recovered in 1972 was taxable income to him in that year under the tax benefit rule. Petitioners brought this proceeding for redetermination of the resulting deficiency in the Tax Court (Pet. App. B3). Petitioner relies on the so-called "erroneous deduction exception" to the tax benefit rule as set forth in two Tax Court cases, *Streckfus Streamers, Inc.* v. *Commissioner*, 19 T.C. 1 (1952), and *Canelo* v. *Commissioner*, 53 T.C. 217, 226-227 (1969), aff'd on other grounds, 447 F. 2d 484 (9th Cir. 1971). These cases held that the rule does not apply where the original deduction was improper.[2]

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[2]Because the Internal Revenue Service now takes the position that the erroneous deduction exception to the tax benefit rule has no validity, the Commissioner has revoked his acquiescences in *Streckfus Streamers* and *Canelo*. See 1981-47 I.R.B. 5.

The Tax Court below held that *Streckfus* and *Canelo* were distinguishable from the present case, and that petitioner was estopped from contending that the deduction he had previously claimed was improper (Pet. App. A8-A9). The Tax Court concluded that this was a "classic" case for application of the tax benefit rule and, therefore, the money must be included in petitioner's income in the year of recovery (*id.* at A8). The court of appeals affirmed. Because the court rejected the erroneous deduction exception, it did not consider the Tax Court's estoppel theory (Pet. App. B1-B7).

1. The decision below correctly held that petitioner was required to restore to income the recovery of money previously paid and deducted. The tax benefit rule provides that a taxpayer who deducts an expenditure in one year and thereby secures a tax benefit must include in income any recovery of that expenditure in a later year.[3] *Rosen* v. *Commissioner*, 611 F. 2d 942, 943 (1st Cir. 1980); *Alice Phelan Sullivan Corp.* v. *United States*, 381 F. 2d 399, 403 (Ct. Cl. 1967).

The court of appeals properly rejected the "erroneous deduction exception" relied upon by petitioner. The rationale of the erroneous deduction exception was that, in the case of an improper deduction, the Commissioner's remedy was to challenge the deduction before the statute of limitations expired. See *Canelo* v. *Commissioner*, *supra*, 53 T.C. at 226-227.[4] But, as the court below correctly recognized

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[3]The "tax benefit rule" has received statutory recognition in the provisions now set forth in Section 111 of the Internal Revenue Code of 1954 (26 U.S.C.). That statute does not, by its terms, codify the rule itself, but serves only to limit the amount of the subsequent inclusion to that portion of the prior deduction that led to an actual tax benefit. See H.R. Rep. No. 2333, 77th Cong., 2d Sess. 45 (1942).

[4]This assumes that the impropriety of the deduction is apparent on the face of the return or that the Commissioner should have known that the deduction was erroneous prior to the expiration of the statute of

(Pet. App. B4-B5), the tax benefit rule, viewed properly, does not serve to circumvent the statute of limitations with respect to a barred year, but simply reflects a new tax event, *e.g.*, a recovery, that takes place in a later year. As such, it is irrelevant whether the original deduction was right or wrong. For the same reason, petitioner's argument (Pet. 5) that rejection of the erroneous deduction exception substantially undermines the statute of limitations in tax matters is without merit. *First Trust & Savings Bank* v. *United States*, 614 F. 2d 1142, 1145 (7th Cir. 1980); *Rosen* v. *Commissioner*, *supra*, 611 F. 2d at 944. In addition, as the court also held (Pet. App. B6-B7), the erroneous deduction exception is "poor public policy." It rewards the taxpayer who has benefited from an improper deduction, while the taxpayer who took a legitimate deduction is required to treat the recovery as income. See *Askin & Marine Co.* v. *Commissioner*, 66 F. 2d 776, 778 (2d Cir. 1933).

2. Petitioner erroneously asserts (Pet. 7-8) that the decision below conflicts with *Ross* v. *Commissioner*, 169 F. 2d 483, 496 (1st Cir. 1948), and *Commissioner* v. *Schuyler*, 196 F. 2d 85 (2d Cir. 1952). Neither case involved either the tax benefit rule or the erroneous deduction exception. In *Ross*, a portion of the taxpayer's salary was not received but accrued to his credit, and the taxpayer changed his method of reporting the accruals to conform to the Commissioner's determination that they were constructively received and, therefore, includable in income when accrued. The court held that the Tax Court erred in attributing to 1939, the year of the change, certain disputed items of accrued salary. Similarly, *Schuyler*, involved a situation where the Commissioner required taxpayers to change from a cash to an

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limitations. See *Mayfair Minerals, Inc.* v. *Commissioner*, 56 T.C. 82 (1971), aff'd per curiam, 456 F. 2d 622 (5th Cir. 1972); Plumb, *The Tax Benefit Rule Today*, 57 Harv. L. Rev. 129, 133, 135 & n.31 (1943).

accrual basis of reporting income and to include in gross income closing inventory. Thus, the court held that the taxpayers were properly permitted to deduct opening inventory. Moreover, the Second Circuit has expressly rejected the theory that when a deduction has been improperly claimed and allowed, recovery of the payment deducted cannot be included in income. See *Askin & Marine Co.* v. *Commissioner, supra,* 66 F. 2d at 778.[5]

3. Nor is there any reason for Congress rather than a court to eliminate the erroneous deduction exception to the tax benefit rule, as petitioner suggests (Pet. 9). The tax benefit rule itself, to which the erroneous deduction exception was grafted by the Tax Court in only two decisions, is a judicially developed doctrine, which was given legislative recognition by the enactment of Section 111. (See page 3, note 3, *supra.*) And, as we have pointed out, the rule does not operate as an exception to the statute of limitations as petitioner assumes, but focuses on the proper treatment in the year of recovery.

Finally, petitioner argues (Pet. 9-14) that the estoppel theory relied on by the Tax Court in this case is preferable to rejection of the exception outright. Petitioner's argument seems quite beside the point, since both the Tax Court and the court of appeals held that the tax benefit rule applied here so that the recovery of the amount previously deducted was taxable. By rejecting the validity of the erroneous

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[5]The court of appeals also noted (Pet. App. B7) that at least three circuits have implicitly rejected or criticized the erroneous deduction exception. See *Union Trust Co.* v. *Commissioner,* 111 F. 2d 60, 61 (7th Cir.), cert. denied, 311 U.S. 658 (1940); *Kahn* v. *Commissioner,* 108 F. 2d 748, 749 (2d Cir. 1940); *Askin & Marine Co.* v. *Commissioner, supra*; *Commissioner* v. *Liberty Bank & Trust Co.,* 59 F. 2d 320, 325 (6th Cir. 1932). Indeed, even the Tax Court, which was the only court to recognize this exception, has severely limited its scope. *Mayfair Minerals, Inc.* v. *Commissioner, supra.*

deduction exception, the court of appeals did not consider the Tax Court's estoppel theory. At all events, the result in this case is the same—petitioner's recovery is includable in income.[6]

It is therefore respectfully submitted that the petition for a writ of certiorari should be denied.

REX E. LEE
Solicitor General

APRIL 1982

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[6]This case has no bearing upon *Hillsboro National Bank* v. *Commissioner*, 641 F. 2d 529 (7th Cir. 1981), cert. granted, No. 81-485 (Jan. 18, 1982), and its companion case, *Bliss Dairy, Inc.* v. *United States*, 645 F. 2d 19 (9th Cir. 1981), cert. granted, No. 81-930 (Jan. 18, 1982). Those cases present conflicting decisions as to whether the tax benefit rule is applicable where the transaction inconsistent with the taxpayer's prior deduction placed no funds in the taxpayer's hands. This case, on the other hand, is, as the Tax Court noted, the classic tax benefit situation where the taxpayer paid out funds and claimed a deduction in one year and received repayment of those funds in a later year. Both the *Hillsboro* court and the *Bliss Dairy* court would apply the tax benefit rule in this case. Indeed, the same court of appeals that upheld application of the tax benefit rule in this case denied (erroneously, we believe) its applicability in *Bliss Dairy*.

DOJ-1983-04